Supreme Court of the United States

OCTOBER TERM, 1968

No. 280

UNITED STATES OF AMERICA,

Petitioner,

—v.—

SKELLY OIL COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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DOCKET ENTRIES IN DISTRICT COURT

No. 6181

1965 DATE	FILINGS—PROCEEDINGS
5-12-65	Complaint, filed. Summons Issued.
5-12-65	Summons returned, filed—served John M. Imel, U. S. Attorney at Tulsa, Okla., on May 12, 1965 and by mailing two copies to the Attorney General, Washington, D. C., by certified mail. (Fee $3.00)
7- 8-65	Defendant's answer, filed.
8- 3-65	Case set for pre-trial on Tuesday, August 17, 1965 at 4:30 P.M. (Fred Daugherty—Judge) 10:00 A.M.
8-12-65	Order removing pre-trial filed, postponed until further notice. (Fred Daugherty—Judge)
8-27-65	Case set for pre-trial on Tuesday, September 7, 1965 at 3:30 P.M. (Fred Daugherty—Judge)
9- 3-65	Case stricken from the pre-trial assignment of September 7, 1965, and case is to be submitted on statement of facts. (Fred Daugherty—Judge)
9- 7-65	Ordered by the Court that the case being submitted on stipulation of facts and briefs, the parties are granted until October 1, 1965 within which to file the stipulation, the plaintiff 30 days thereafter to file brief, the defendant 30 days thereafter to file answer brief, the plaintiff 20 days thereafter to file reply brief. (Fred Daugherty—Judge)
10- 1-65	Joint stipulation of facts, filed.
10-26-65	Brief of the plaintiff, filed.
11-26-65	Ordered by the Court that the defendant is granted until January 1, 1966 to file an answer brief and the plaintiff 20 days thereafter to file a reply brief. (Fred Daugherty—Judge)
1- 5-66	Defendant's motion for extension of time for filing answer brief, filed.

1966 DATE	FILINGS—PROCEEDINGS
1- 5-66	Order (a part of motion) filed granting USA until January 10, 1966 in which to file its answer brief. (NCH-BBB)
1- 7-66	Defendant's motion for extension of time for filing answer brief, filed.
1- 7-66	Order (a part of motion) filed, granting USA until January 10, 1966, in which to file its answer brief. (Fred Daugherty—Judge)
1-10-66	Brief of the defendant, filed.
1-27-66	Reply brief for plaintiff, filed.
6- 2-66	Findings of Fact, Conclusions of Law and Decision, filed; plaintiff recover stipulated amount, judgment in the sum of $20,932.64 plus interest against the defendant, defendant directed to prepare judgment. (Fred Daugherty—Judge) copies mailed.
6-21-66	Judgment filed and entered that in accordance with the parties' stipulation of facts, that the plaintiff have and recover of and from the defendant the amount of $20,932.64 with interest; and that the complaint and action be dismissed with prejudice insofar as any recovery greater than that above. (Fred Daugherty—Judge)
6-21-66	Copies of judgment mailed to counsel of record.
6-22-66	Notice of appeal, filed. Copy delivered to U. S. Attorney.
6-22-66	Designation of contents of record on appeal, filed.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OKLAHOMA

Pleas And Proceedings Before The Honorable Fred Daugherty, Judge Of The United States District Court For The Eastern, Western And Northern Districts Of Oklahoma, Presiding In The Following Entitled Cause:

SKELLY OIL COMPANY, PLAINTIFF

vs.

UNITED STATES OF AMERICA, DEFENDANT

No. 6181, Civil

COMPLAINT

The above named Plaintiff for its Complaint hereby alleges as follows:

I. This is an action arising under the Internal Revenue Laws of the United States, of which this Court has jurisdiction pursuant to Title 28, United States Code, Section 1346(a)(1).

II. Plaintiff is a corporation duly organized and existing under the laws of the State of Delaware, and maintains its principal office at 1437 South Boulder, Tulsa, Oklahoma.

III. This action is brought for an overpayment of income tax for the taxable year ended December 31, 1958 in the amount of $96,809.82, or such further amount as may be legally refundable, together with statutory interest thereon.

IV. At all times pertinent hereto, plaintiff has kept its books and filed its Federal income tax returns on the accrual basis, utilizing a calendar year.

V. (a) At all times pertinent hereto, Plaintiff has been a "regulated public utility" as defined in Section 7701

(a) (33) without regard to the limitation contained in the last two sentences thereof [formerly Section 1503 (c) without regard to paragraph 2 thereof] of the Internal Revenue Code of 1954, within the meaning of Section 1341 (b) (2) of such Code.

(b) During its taxable year ended December 31, 1958, Plaintiff, in settlement of litigation or under threat or imminence of litigation, was required to refund and repay $500,000.00 to Cities Service Gas Company and $5,536.54 to Dorchester Corporation, or a total of $505,536.54.

(c) The aggregate $505,536.54 represented excessive rate charges made by Plaintiff to Cities Service Gas Company and Dorchester Corporation with respect to natural gas produced by Plaintiff from its natural gas reserves, which was sold by Plaintiff to Cities Service Gas Company and Dorchester Corporation during the calendar years 1952 through 1957, inclusive.

(d) The entire $505,536.54 was included in Plaintiff's gross income for Federal income tax purposes during the period 1952 through 1957, inclusive, because Plaintiff had an unrestricted right thereto, in the following amounts:

Taxable Year Ended December 31	Cities Service Gas Company	Dorchester Corporation	Total
1957	$ 67,668.17	$1,276.07	$ 68,944.24
1956	93,094.52	1,406.23	94,500.75
1955	93,018.88	1,810.53	94,829.41
1954	120,064.70	1,043.71	121,108.41
1953	91,972.49	—	91,972.49
1952	34,181.24	—	34,181.24
Total	$500,000.00	$5,536.54	$505,536.54

VI. (a) Under date of September 14, 1959, Plaintiff timely filed its 1958 Federal income tax return (Form 1120).

(b) On its 1958 return, Plaintiff deducted the $505,536.54 it was required to restore in such year to Cities Service Gas Company and Dorchester Corporation, which, with other items contained therein, produced a tax liability for 1958 of $5,214,382.49.

(c) Said tax liability of $5,214,382.49 was paid by Plaintiff on the dates and in the amounts set forth below to the District Director of Internal Revenue, Oklahoma City District:

Date of Payment	Amount of Payment
10/13/58	$ 880,000.00
12/12/58	1,000,000.00
3/12/59	2,018,904.10
6/12/59	1,315,478.39
	$5,214,382.49

(d) On or about September 25, 1961, Plaintiff filed an amended Federal income tax return for its taxable year ended December 31, 1958, which reflected an additional tax due for such year in the amount of $2,618.84.

(e) Plaintiff paid said additional tax of $2,618.84, together with interest thereon of $397.13 on or about September 25, 1961 to the District Director of Internal Revenue, Oklahoma City District.

(f) Under date of July 6, 1962, Plaintiff received from the District Director of Internal Revenue, Oklahoma City District, a Revenue Agent's Report with respect to its taxable year ended December 31, 1958. Among other adjustments, such Report erroneously reduced Plaintiff's allowable percentage depletion deduction for 1958 by the amount of $159,475.09.

(g) Based upon the findings contained in such Revenue Agent's Report, the then Commissioner of Internal Revenue made the following additional assessments of income tax and interest thereon:

Tax	Interest
$80,790.14	$16,019.68

(h) Plaintiff paid such additional assessment of income tax on July 5, 1962, and interest thereon was paid on September 4, 1962, to the District Director of Internal Revenue, Oklahoma City District.

(i) On July 2, 1964, Plaintiff filed with the District Director of Internal Revenue, Oklahoma City District, a Claim For Refund (Form 843) for overpayment of in-

come tax for its taxable year ended December 31, 1958, in the amount of $80,790.14, or such further amount as may be legally refundable, together with statutory interest thereon. Such Claim For Refund alleged that the Commissioner erred in reducing Plaintiff's 1958 percentage depletion allowance by the amount of $159,475.09.

(j) On January 21, 1965, Plaintiff was notified by the District Director of Internal Revenue, Oklahoma City District, that its Claim For Refund in the amount of $80,790.14 had been disallowed.

(k) Under date of March 23, 1965, Plaintiff filed with the District Director of Internal Revenue, Oklahoma City District, an executed Waiver Of Statutory Notification Of Claim Disallowance (Form 2297).

(l) Inasmuch as more than six months have expired since the filing of Plaintiff's Claim For Refund, Plaintiff brings this action for its taxable year ended December 31, 1958 pursuant to the provisions of Section 6532(a) of the Internal Revenue Code of 1954.

VII. Section 1341 of the Internal Revenue Code of 1954 sets forth the mandatory provisions which govern the computation of tax for a taxable year in which a taxpayer is required to restore a substantial amount which had been included in its gross income in prior taxable years because it was received under a claim of right without restrictions as to its use. Pursuant to Section 1341(a) of the Internal Revenue Code of 1954, the tax for the taxable year in which such restoration is required shall be the lesser of:

(a) The tax for such taxable year with the amount required to be restored treated as a deduction as computed under Section 1341(a)(4) of the Internal Revenue Code of 1954; or

(b) The tax for such taxable year without the amount required to be restored treated as a deduction, minus the decrease in tax for the prior taxable years which would result solely from the exclusion of the amount required to be restored from gross income for such prior taxable years as computed under Section 1341(a)(5) of the Internal Revenue Code of 1954.

VIII, (a) Computation of Plaintiff's tax for its taxable year ended December 31, 1958, under the provisions of Section 1341(a)(4) of the Internal Revenue Code of 1954 produces a tax of $5,214,864.42.

(b) Computation of Plaintiff's tax for its taxable year ended December 31, 1958 under the provisions of Section 1341(a)(5) of the Internal Revenue Code of 1954 produces a tax of $5,214,864.42.

(c) Inasmuch as Plaintiff's tax for its taxable year ended December 31, 1958 under subparagraph (b) of this paragraph is not less than the tax under subparagraph (a) of this paragraph, the tax for such year is to be computed under subparagraph (a) of this paragraph.

IX. Plaintiff has overpaid its tax for the taxable year ended December 31, 1958 in the amount of $82,927.05, which, together with interest assessed and collected thereon in the amount of $16,019.68, constitutes an aggregate overpayment of $98,946.73.

X. (a) In determining Plaintiff's Federal income tax liability for the taxable year ended December 31, 1958, the Commissioner erroneously failed to apply the provisions of Section 1341 of the Internal Revenue Code of 1954 to determine the effect thereon of the $505,536.54 which Plaintiff was required to restore during such year.

(b) More particularly, the Commissioner erroneously failed to compute the tax effect, for Plaintiff's taxable year ended December 31, 1958, of the $505,536.54 which Plaintiff was required to restore during such year under the provisions of Section 1341(a)(4) of the Internal Revenue Code of 1954.

(c) More particularly, in the event the Commissioner attempted to apply the provisions of Section 1341 of the Internal Revenue Code of 1954 to determine the effect on Plaintiff's Federal income tax liability of the $505,536.54 which Plaintiff was required to restore during such year, his application thereof was erroneous in that he reduced Plaintiff's allowable percentage depletion deduction for the taxable year ended December 31, 1958 in the amount of $159,475.09.

(d) In determining Plaintiff's Federal income tax liability for its taxable year ended December 31, 1958, the

Commissioner erroneously reduced its allowable percentage depletion deduction by the amount of $159,475.09.

(e) The actions of the Commissioner enumerated in subparagraphs (a), (b), (c), and (d) of this paragraph were erroneous, illegal and without warrant in law.

XI. By reason of the facts set forth in this Complaint, there is due and owing from Defendant to Plaintiff the amount of $96,809.82, or such further amount as this Court may find due and owing from Defendant to Plaintiff, with interest thereon as provided by law. Such amount of $96,809.82 was erroneously and illegally collected from Plaintiff for its taxable year ended December 31, 1958.

XII. Although repayment of the said amount of $96,809.82 has been demanded, no part thereof has been credited, remitted, refunded or repaid to Plaintiff or to anyone on Plaintiff's account.

XIII. Wherefore, Plaintiff demands judgment against Defendant in the principal amount of $96,809.82, or such further amount as this Court may find to be legally due and owing by Defendant to Plantiff, together with interest thereon as provided by law.

ROBERT J. CASEY
DONALD P. MOYERS

Of Counsel:

CLARK, CARR & ELLIS

Filed May 12, 1965.

ANSWER

The defendant, United States of America, by its attorney, John M. Imel, United States Attorney for the Northern District of Oklahoma, for its answer to the complaint herein, alleges as follows:

I. Admits the allegations contained in paragraph I.

II. Admits the allegations contained in paragraph II, except alleges that it is without knowledge or information sufficient to form a belief as to the truth of the alle-

gation that plaintiff's principal office is at 1437 South Boulder, Tulsa, Oklahoma.

III. Admits the allegations contained in Paragraph III, except denies that the plaintiff has overpaid its tax for the year ended December 31, 1958, or that any sum is legally refundable to it.

IV. Alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph IV, except admits that the plaintiff filed its return on a calendar year basis during the year in question.

V. Alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph V(a) through (d), except to allege that the plaintiff's 1952 through 1958 federal income tax returns speak for themselves.

VI. (a) Admits the allegations contained in paragraph VI(a).

(b) Admits that the plaintiff's federal income tax return for 1958 reflected a tax due thereon in the amount of $5,214,382.49. Alleges that it is without knowledge or information sufficient to form a belief as to the truth of the remaining allegations contained in paragraph VI(b), and further alleges said tax return speaks for itself.

(c) Admits the allegations contained in paragraph VI(c).

(d) Admits the allegations contained in paragraph VI(d).

(e) Admits the allegations contained in paragraph VI(e).

(f) Alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph VI(f), except denies that the plaintiff's allowable depletion deduction for 1958 was erroneously reduced.

(g) Admits that additional assessments were made against the plaintiff in the amounts alleged, but alleges that it is without knowledge or information sufficient to form a belief as to the truth of the remaining allegations contained in paragraph VI(g).

(h) Admits the allegations contained in paragraph VI(h).

(i) Alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph VI(i), except admits the allegations contained in the first sentence thereof, and further alleges that said claim for refund speaks for itself.

(j) Denies the allegations contained in paragraph VI(j).

(k) Admits the allegations contained in paragraph VI(k).

(l) Admits the allegations contained in paragraph VI(l).

VII. Alleges that is is neither required to admit or deny the allegations contained in paragraph VII(a) and (b), as said allegations are purely questions of law, and further alleges that Section 1341(a) of the Internal Revenue Code of 1954 speaks for itself.

VIII. (a) Alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph VIII(a), and further alleges that any computation of the plaintiff's income tax liability speaks for itself.

(b) Alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph VIII(b), and further alleges that any computation of the plaintiff's income tax liability speaks for itself.

(c) Denies the allegations contained in paragraph VIII(c).

IX. Denies the allegations contained in paragraph IX.

X. Denies the allegations contained in paragraph X (a), (b), (c), (d), and (e), except admits that the defendant reduced the depletion deduction claimed by the defendant by the sum of $159,475.09.

XI. Denies the allegations contained in paragraph XI.

XII. Admits the allegations contained in paragraph XII.

Wherefore, the defendant prays that judgment be entered dismissing with prejudice the plaintiff's complaint

and allowing the defendant its costs and disbursements, and for such other and further relief as to the Court may appear just and proper.

LAWRENCE H. MCLOUD
Assistant United States Attorney

Filed July 8, 1965.

JOINT STIPULATION OF FACTS

It is hereby stipulated by and between the parties to this proceeding that the facts herein set forth are true, and may be considered as evidence in this case, subject to objection as to their relevance or materiality, and further subject to the right of either party hereto to adduce further evidence at the trial of this proceeding not inconsistent with the facts hereinafter set forth.

1. Plaintiff, at all times pertinent hereto, was a corporation duly organized and existing under the laws of the State of Delaware, and maintained its principal office at 1437 South Boulder, Tulsa, Oklahoma.

2. Jurisdiction to hear and determine this action is conferred upon this Court by Title 28, United States Code, Section 1346(a)(1).

3. This action is brought for the recovery of $96,809.82, representing Federal income tax collected from the plaintiff for the taxable year ended December 31, 1958 (hereinafter referred to as the taxable year), or such further amount, if any, as may be legally refundable together with statutory interest thereon.

4. The only issue presented to this Court for decision herein is whether, in computing plaintiff's liability for federal income tax for the taxable year ending December 31, 1958 under the provisions of Section 1341(a)(4) of the 1954 Internal Revenue Code, it was proper to reduce its otherwise allowable percentage depletion for the taxable year by $139,022.55, representing 27½ percent of $505,536.54, the purchase price received by it from the sale of natural gas during prior taxable years, which purchase price had been included by it in gross income for such prior taxable years under a claim of right with-

out restriction as to use, and which it was required to restore to the payors thereof during the taxable year ending December 31, 1958; or, in the alternative, whether plaintiff is required to reduce its otherwise allowable deduction under Section 1341(a)(4) of $505,536.54 by 27½ percent, or $139,022.55, to reflect percentage depletion previously claimed and allowed thereon in its federal income tax returns for the years in which such amount was taken into gross income under a claim of right without restriction as to use.

5. At all times pertinent hereto, plaintiff has kept its books and filed its federal income tax returns on the accrual basis, utilizing a calendar year.

6. (a) Under date of September 14, 1959 plaintiff timely filed its 1958 federal income tax return, which showed a liability for tax of $5,214,382.49.

(b) Said tax liability of $5,214,382.49 was paid by plaintiff on the dates and in the amounts set forth below to the District Director of Internal Revenue, Oklahoma City District:

Date of Payment	Amount of Payment
10/13/58	$ 880,000.00
12/12/58	1,000,000.00
3/12/59	2,018,904.10
6/12/59	1,315,478.39
	$5,214,382.49

(c) On or about September 25, 1961, plaintiff filed an amended federal income tax return for its taxable year ended December 31, 1958, which reflected an additional tax due for such year in the amount of $2,618.84.

(d) Plaintiff paid said additional tax of $2,618.84, together with interest thereon of $397.13 on or about September 25, 1961 to the District Director of Internal Revenue, Oklahoma City District.

7. (a) Under date of July 6, 1962, plaintiff received from the District Director of Internal Revenue, Oklahoma City District, a revenue agent's report, dated July 5, 1962, with respect to its taxable year ended December 31, 1958.

(b) Said report proposed certain adjustments to plaintiff's income for the taxable year, and further proposed a net deficiency in income tax for the taxable year in the amount of $80,790.14.

(c) Pursuant to this report, the then Commissioner of Internal Revenue made an additional assessment of income tax of $80,790.14 and interest thereon of $16,019.68 for the taxable year.

(d) Plaintiff paid such additional assessment of income tax on July 5, 1962, and interest thereon was paid September 4, 1962 to the District Director of Internal Revenue, Oklahoma City District.

8. (a) On July 2, 1964, plaintiff filed with the District Director of Internal Revenue, Oklahoma City District, a claim for refund for the overpayment of income tax for its taxable year ended December 31, 1958, in the amount of $80,790.14, or such further amount, if any, as might be legally refundable, together with statutory interest thereon. Such claim for refund alleged that Commissioner erred in reducing plaintiff's 1958 percentage depletion allowance by the amount of $159,475.09.

(b) On January 21, 1965, plaintiff was notified that the District Director of Internal Revenue, Oklahoma City District, proposed to disallow said claim for refund.

(c) Under date of March 23, 1965, plaintiff filed with the District Director of Internal Revenue, Oklahoma City District, a waiver of statutory notification of claim disallowance with respect to said claim for refund.

(d) No action or suit has been commenced or is pending in any other court on account of this claim for refund. Plaintiff is the owner of such claim for refund, and no assignment or transfer of legal title thereto has been made.

9. (a) At all times, material hereto, plaintiff was an independent producer of natural gas, engaged in the sale thereof pursuant to rates established or approved by the Oklahoma Corporation Commission and/or the Federal Power Commission. As such, it owned and operated certain oil and gas leases in the Guymon-Hugoton Gas Field located in the States of Kansas, Oklahoma, and Texas (hereafter referred to as the Hugoton Field.)

(b) Under gas purchase contracts dated August 28, 1945, plaintiff commenced making sales of gas produced from certain of its interests in the Hugoton Field in Texas County, Oklahoma to Cities Service Gas Company (hereafter referred to as Cities Service.).

(c) Immediately prior to August 1, 1952, the price being paid by Cities Service to plaintiff pursuant to these agreements for all gathered and wellhead gas purchases was 8.4863 cents per Mcf when computed on a pressure base of 14.65 psia (per square inch absolute).

(d) In addition to the August 28, 1945 gas purchase contracts, plaintiff sold and delivered natural gas to Cities Service at the wellhead under certain joint operating agreements covering other of plaintiff's interests in the Hugoton Field in Texas County, Oklahoma, where Cities Service was denominated as the Gas Operator.

(e) Immediately prior to August 1, 1952, the price being paid by Cities Service to plaintiff pursuant to such joint operating agreements for the gas sold and delivered thereunder was 8.9329 cents per Mcf (14.65 psia).

(f) On July 29, 1952 the Corporation Commission of the State of Oklahoma, by Order effective August 1, 1952, determined that no gas could be produced from any well in the Guymon-Hugoton Field, Texas County, Oklahoma, except at a price not less than 9.8262 cents per Mcf (14.65 psia) if sold at the wellhead, or, if not sold at the wellhead, at a price equivalent to not less than 9.8262 cents per Mcf (14.65 psia) plus the reasonable cost of gathering.

(g) On and after the effective date of this Order, plaintiff was required to charge, and did charge, and Cities Service was required to pay, and did pay, an additional 1.3399 cents per Mcf (14.65 psia) for sales and purchases under the August 28, 1945 gas purchase contracts, and an additional .8933 cents per Mcf (14.65 psia) for sales and purchases under the joint operating agreements.

10. (a) On March 20, 1958, the Supreme Court of Oklahoma, pursuant to Mandate of the Supreme Court of the United States in the proceeding Michigan-Wisconsin Pipeline Co., et al. v. Corporation Commission of

Oklahoma, 355 U.S. 425 (1958), issued an Order and Mandate, vacating the Oklahoma Minimum Price Order in its entirety. On March 27, 1958, the Supreme Court of the State of Oklahoma issued a similar order vacating the Oklahoma Minimum Price Order in its entirety in the proceeding commenced by Cities Service which was then pending before it on stipulation.

(b) On or about April 8, 1958, Cities Service filed a complaint in the Superior Court of New Castle County, Delaware (Civil Action No. 370), wherein it alleged that plaintiff was indebted to it in the principal sum of $777,853.25, representing alleged overcharges for gas purchased from plaintiff by Cities Service during the period commencing August 1, 1952 through and including December 22, 1957. As the basis for its complaint, Cities Service alleged that during the aforesaid period it had made purchases from plaintiff of natural gas in the Hugoton Field, paying the minimum price required by the Oklahoma Minimum Price Order, and further alleged that the invalidation of this Order ab initio by the Oklahoma Supreme Court entitled it to a refund of all amounts in excess of the amounts which it was contractually obligated to pay to plaintiff during the period commencing August 1, 1952 through and including December 22, 1957.

(c) On September 10, 1958, Cities Service proposed to plaintiff a compromise settlement agreement with respect to such litigation, wherein it agreed to terminate the controversy upon the payment by plaintiff to Cities Service of the sum of $500,000. This proposal was conditioned upon the acceptance by the Federal Power Commission of certain amendments to the gas purchase contracts of August 28, 1945. Plaintiff accepted and agreed to this settlement on October 6, 1958.

(d) On November 5, 1958, the Federal Power Commission formally accepted the aforementioned amendments to the 1945 contracts between the parties.

(e) Concurrent with such acceptance, plaintiff was required to refund and repay to Cities Service the aggregate amount of $500,000 in settlement of the litigation commenced against it by said Cities Service.

(f) On December 8, 1958, by order of the Superior Court of New Castle County, Delaware, Cities Service,

Civil Action No. 370 was dismissed upon stipulation of the parties with prejudice.

(g) The entire $500,000 which plaintiff was required to restore to Cities Service during the taxable year had been included in plaintiff's gross income for federal income tax purposes during the taxable years 1952 through 1957, inclusive, because plaintiff had an unrestricted right thereto in the following amounts:

Taxable year ended December 31	Amount Included In Plaintiff's Gross Income
1957	$ 67,668.17
1956	93,094.52
1955	93,018.88
1954	120,064.70
1953	91,972.49
1952	34,181.24
	$500,000.00

The above stated amounts were included in plaintiff's gross income from the property in each of the respective years for the purposes of computing plaintiff's depletion allowance at the rate of 27½ percent, pursuant to the provisions of Section 613, Internal Revenue Code of 1954, and said amounts were included in gross income in each of such respective years. In determining plaintiff's taxable income for each of such respective years, upon which federal income taxes were assessed and paid, said percentage depletion which was claimed and allowed at the rate of 27½ percent of the above stated amounts, and other deductions, was deducted from the amounts included in plaintiff's gross income as above stated.

11. (a) In addition to the operating interests set forth above, plaintiff owned certain other mineral interests in the Hugoton Field, which were operated for it by the Dorchester Corporation (hereinafter referred to as Dorchester).

(b) At all times, material hereto, Dorchester was an independent producer of natural gas in Oklahoma. On July 1, 1954, Dorchester commenced sales of natural gas for plaintiff's account to Natural Gas Pipeline Company of America (hereinafter referred to as Natural) at 9.8262 cents per Mcf (14.65 psia), the then existing mini-

mum price established by the Oklahoma Corporation Commission's Order of July 29, 1952.

(c) Commencing July 1, 1954, Dorchester collected and paid over to plaintiff 9.8262 cents per Mcf (14.65 psia) on account of all gas sold by it to Natural from plaintiff's interests.

(d) As the result of litigation commenced by Natural, and as the result of the invalidation of the Oklahoma Minimum Price Order, as more fully set forth above, it was ultimately determined that the proper contractual price for natural gas sold and delivered by Dorchester to Natural from July 1, 1954 was 6.253 cents per Mcf (14.65 *psia*).

(e) Accordingly, Dorchester was required to refund to Natural all charges in excess of 6.253 cents per Mcf for gas sold by it to Natural, including gas sold by it as Operator for plaintiff's account.

(f) On September 26, 1958, Dorchester by formal notice demanded reimbursement from plaintiff of so much of the overcharge as was attributable to plaintiff's interest, or $5,536.54, stating in part:

"We must, of course, now recover from you the overpayment just as Natural is recovering it from us. There is no question of our legal right to do this, for the United States Court of Appeals has in effect ruled that we should have been paid at the contract rate all along by Natural, and in turn payments to your interest should have been made at the contract rate."

(g) On October 22, 1958, plaintiff restored and refunded to Dorchester the entire $5,536.54.

(h) The entire $5,536.54 which plaintiff was required to restore to Dorchester during the taxable year had been included in plaintiff's gross income for federal income tax purposes during the taxable years 1954 through 1957, inclusive, because plaintiff had an unrestricted right thereto, in the following amounts:

Taxable Year Ended December 31	Amount Included In Plaintiff's Gross Income
1957	$1,276.07
1956	1,406.23
1955	1,810.53
1954	1,043.71
	$5,536.54

The above stated amounts were included in plaintiff's gross income from the property in each of the respective years for the purposes of computing plaintiff's depletion allowance at the rate of 27½ percent, pursuant to the provisions of Section 613, Internal Revenue Code of 1954, and said amounts were included in gross income in each of such respective years. In determining plaintiff's taxable income for each of such respective years, upon which federal income taxes were assessed and paid, said percentage depletion which was claimed and allowed at the rate of 27½ percent of the above stated amounts, and other deductions, was deducted from the amounts included in plaintiff's gross income as above stated.

12. (a) In addition to the amounts which plaintiff was required to restore to Cities Service and Dorchester during the taxable year as set forth above, plaintiff was required to make similar restorations to Kansas-Nebraska Natural Gas Company, Northern Natural Gas Company, Interstate Gas Company, and the Texas Company. These restorations were required to be made by plaintiff during the taxable years in the amounts as set forth below:

Restored to	Amount of Restoration	Restoration Required To Be Made In Taxable Year Ending December 31
Kansas-Nebraska Natural Gas Company	$53,673.80	1959
Interstate Gas Company	3,765.96	1960
Northern Natural Gas Co.	2,498.63	1961
The Texas Company	62,210.79	1961

13. (a) On its federal income tax return for the taxable year plaintiff deducted $505,536.54, which it was re-

quired to restore during such year to Cities Service and Dorchester as more fully set forth above.

(b) On its federal income tax return for the taxable year ending December 31, 1959, plaintiff deducted $53,673.80, which it was required to restore to Kansas-Nebraska Natural Gas Company during such year.

(c) On its federal income tax return for the taxable year ending December 31, 1960, plaintiff deducted $3,765.96, which it was required to restore to Interstate Gas Company during such year.

(d) On its federal income tax return for the taxable year ending December 31, 1961, plaintiff deducted $2,498.63 and $62,210.79, which it was required to restore to Northern Natural Gas Company and the Texas Company, respectively, during such year.

14. So far as material hereto, the audit of plaintiff's federal income tax return for the taxable year resulted in the reduction of its otherwise allowable percentage depletion for the taxable year by $159,475.09, representing 27½ percent of the following:

(a) The amount of $452,861.82 with respect to the Cities Service restoration.

(b) The amount of $4,898.43 with respect to the Dorchester restoration.

(c) The amount of $53,673.80 which it was required to restore to Kansas-Nebraska Natural Gas Company during the taxable year ending December 31, 1959.

(d) The amount of $3,765.96 which plaintiff was required to restore to Interstate Gas Company during the taxable year ending December 31, 1960.

(e) The amounts of $2,498.63 and $62,210.79 which Plaintiff was required to restore to Northern Natural Gas Company and The Texas Company, respectively, during the taxable year ending December 31, 1961.

15. (a) Apart from the issue remaining before this Court for decision, Plaintiff is entitled to judgment for recovery of tax in the amount of $17,468.76, plus assessed interest in the amount of $3,463.88, a total of $20,932.64, plus statutory interest thereon, as provided by law, from the respective dates of payment of July 5, 1962,

with respect to the tax, and September 4, 1962, with respect to the interest assessed thereon.

(b) Any additional amount due the Plaintiff, if any, under this Court's decision will be computed by the parties and presented to this Court for the entry of judgment.

ROBERT J. CASEY
For Plaintiff
JOHN M. IMEL
JOHN O. JONES
For Defendant

Dated: September —, 1965.

Filed October 1, 1965.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DECISION

This case has been submitted to the Court for decision on the merits on a Joint Stipulation of Facts and the briefs of both parties.

ISSUE

The issue for determination herein is stated alternatively in the Joint Stipulation of Facts as follows:

"The only issue presented to this Court for decision herein is whether, in computing plaintiff's liability for federal income tax for the taxable year ending December 31, 1958 under the provisions of Section 1341(a)(4) of the 1954 Internal Revenue Code, it was proper to reduce its otherwise allowable percentage depletion for the taxable year by $139,022.55 representing 27½ percent of $505,536.54, the purchase price received by it from the sale of natural gas during prior taxable years, which purchase price had been included by it in gross income for such prior taxable years under a claim of right without restriction as to use, and which it was required to restore to the payors thereof during the taxable year ending December 31, 1958; or, in the alternative, whether plaintiff is required to reduce its otherwise allowable de-

duction under Section 1341(a)(4) of $505,536.54 by 27½ percent, or $139,022.55, to reflect percentage depletion previously claimed and allowed thereon in its federal income tax returns for the years in which such amount was taken into gross income under a claim of right without restriction as to use."

FINDINGS OF FACT

The following Findings of Fact are pertinent to the issue and are made herein:

1. This action is brought for the recovery of $96,809.82, representing Federal income tax collected from plaintiff for the taxable year ended December 31, 1958, or such further amount, if any, as may be legally refundable together with statutory interest thereon.

2. (a) At all times, material hereto, plaintiff was an independent producer of natural gas, engaged in the sale thereof pursuant to rates established or approved by the Oklahoma Corporation Commission and/or the Federal Power Commission. As such, it owned and operated certain oil and gas leases in the Guymon-Hugoton Gas Field located in the States of Kansas, Oklahoma, and Texas (hereafter referred to as the Hugoton Field).

(b) Under gas purchase contracts dated August 28, 1945, plaintiff commenced making sales of gas produced from certain of its interests in the Hugoton Field in Texas County, Oklahoma to Cities Service Gas Company (hereafter referred to as Cities Service).

(c) Immediately prior to August 1, 1952, the price being paid by Cities Service to plaintiff pursuant to these agreements for all gathered and wellhead gas purchases was 8.4863 cents per Mcf when computed on a pressure base of 14.65 psia (per square inch absolute).

(d) In addition to the August 28, 1945 gas purchase contracts, plaintiff sold and delivered natural gas to Cities Service at the wellhead under certain joint operating agreements covering other of plaintiff's interests in the Hugoton Field in Texas County, Oklahoma, where Cities Service was denominated as the Gas Operator.

(e) Immediately prior to August 1, 1952, the price being paid by Cities Service to plaintiff pursuant to such

joint operating agreements for the gas sold and delivered thereunder was 8.9329 cents per Mcf (14.65 psia).

(f) On July 29, 1952 the Corporation Commission of the State of Oklahoma, by Order effective August 1, 1952, determined that no gas could be produced from any well in the Hugoton Field, Texas County, Oklahoma, except at a price not less than 9.8262 per Mcf (14.65 psia) if sold at the wellhead, or, if not sold at the wellhead, at a price equivalent to not less than 9.8262 cents per Mcf (14.65 psia) plus the reasonable cost of gathering.

(g) On and after the effective date of this Order, plaintiff was required to charge, and did charge, and Cities Service was required to pay, and did pay, an additional 1.3399 cents per Mcf (14.65 psia) for sales and purchases under the joint operating agreements.

3. (a) On March 20, 1958, the Supreme Court of Oklahoma, pursuant to Mandate of the Supreme Court of the United States in the proceeding Michigan-Wisconsin Pipeline Co., et al. v. Corporation Commission of Oklahoma, 355 U.S. 425 (1958), issued an Order and Mandate, vacating the Oklahoma Minimum Price Order in its entirety. On March 27, 1958, the Supreme Court of the State of Oklahoma issued a similar order vacating the Oklahoma Minimum Price Order in its entirety in the proceeding commenced by Cities Service which was then pending before it on stipulation.

(b) On or about April 8, 1958, Cities Service filed a complaint in the Superior Court of New Castle County, Delaware, (Civil Action No. 370), wherein it alleged that plaintiff was indebted to it in the principal sum of $777,853.25, representing alleged overcharges for gas purchased from plaintiff by Cities Service during the period commencing August 1, 1952 through and including December 22, 1957. As the basis for its complaint, Cities Service alleged that during the aforesaid period it had made purchases from plaintiff of natural gas in the Hugoton Field, paying the minimum price required by the Oklahoma Minimum Price Order, and further alleged that the invalidation of this Order ab initio by the Oklahoma Supreme Court entitled it to a refund of all amounts in excess of the amounts which it was contractually obligated to pay

to plaintiff during the period commencing August 1, 1952 through and including December 22, 1957.

(c) On September 10, 1958, Cities Service proposed to plaintiff a compromise settlement agreement with respect to such litigation, wherein it agreed to terminate the controversy upon the payment by plaintiff to Cities Service of the sum of $500,000.00. This proposal was conditioned upon the acceptance by the Federal Power Commission of certain amendments to the gas purchase contracts of August 28, 1945. Plaintiff accepted and agreed to this settlement on October 6, 1958.

(d) On November 5, 1958, the Federal Power Commission formally accepted the aforementioned amendments to the 1945 contracts between the parties.

(e) Concurrent with such acceptance, plaintiff was required to refund and repay to Cities Service the aggregate amount of $500,000 in settlement of the litigation commenced against it by said Cities Service.

(f) On December 8, 1958, by order of the Superior Court of New Castle County, Delaware, Cities Service, Civil Action No. 370 was dismissed upon stipulation of the parties with prejudice.

(g) The entire $500,000.00 which plaintiff was required to restore to Cities Service during the taxable year had been included in plaintiff's gross income for federal income tax purposes during the taxable years 1952 through 1957, inclusive, because plaintiff had an unrestricted right thereto in the following amounts:

Taxable year ended December 31	Amount Included in Plaintiff's Gross Income
1957	$ 67,668.17
1956	93,094.52
1955	93,018.88
1954	120,064.70
1953	91,972.49
1952	34,181.24
	$500,000.00

The above stated amounts were included in plaintiff's gross income from the property in each of the respective years for the purposes of computing plaintiff's depletion allowance therefrom at the rate of 27½ percent, pursuant

to the provisions of Section 613, Internal Revenue Code of 1954, and said amounts before the depletion allowances were taken were included in gross income in each of such respective years. In determining plaintiff's taxable income for each of such respective years, upon which federal income taxes were assessed and paid, said percentage depletion which was claimed and allowed at the rate of 27½ percent of the above stated amounts, and other deductions, was deducted from the amounts included in plaintiff's gross income as above stated.

4. (a) In additions to the operating interests set forth above, plaintiff owned certain other mineral interests in the Hugoton Field, which were operated for it by the Dorchester Corporation (hereinafter referred to as Dorchester.)

(b) At all times, material hereto, Dorchester was an independent producer of natural gas in Oklahoma. On July 1, 1954, Dorchester commenced sales of natural gas for plaintiff's account to Natural Gas Pipeline Company of America (hereinafter referred to as Natural) at 9.8262 cents per Mcf (14.65 psia), the then existing minimum price established by the Oklahoma Corporation Commission's Order of July 29, 1952.

(c) Commencing July 1, 1954, Dorchester collected and paid over to plaintiff 9.8262 cents per Mcf (14.65 psia) on account of all gas sold by it to Natural from plaintiff's interests.

(d) As the result of litigation commenced by Natural, and as the result of the invalidation of the Oklahoma Minimum Price Order, as more fully set forth above, it was ultimately determined that the proper contractual price for natural gas sold and delivered by Dorchester to Natural from July 1, 1954 was 6.253 cents per Mcf (14.65 psia).

(e) Accordingly, Dorchester was required to refund to Natural all charges in excess of 6.253 cents per Mcf for gas sold by it to Natural, including gas sold by it as Operator for plaintiff's account.

(f) On September 26, 1958, Dorchester by formal notice demanded reimbursement from plaintiff of so much of the overcharge as was attributable to plaintiff's interest, or $5,536.54, stating in part:

"We must, of course, now recover from you the overpayment just as Natural is recovering it from us. There is no question of our legal right to do this, for the United States Court of Appeals has in effect ruled that we should have been paid at the contract rate all along by Natural, and in turn payments to your interest should have been made at the contract rate."

(g) On October 22, 1958, plaintiff restored and refunded to Dorchester the entire $5,536.54.

(h) The entire $5,536.54 which plaintiff was required to restore to Dorchester during the taxable year had been included in plaintiff's gross income for federal income tax purposes during the taxable years 1954 through 1957, inclusive, because plaintiff had an unrestricted right thereto, in the following amounts:

Taxable Year Ended December 31	Amount Included In Plaintiff's Gross Income
1957	$1,276.07
1956	1,406.23
1955	1,810.53
1954	1,043.71
	$5,536.54

The above stated amounts were included in plaintiff's gross income from the property in each of the respective years for the purposes of computing plaintiff's depletion allowance therefrom at the rate of 27½ percent, pursuant to the provisions of Section 613, Internal Revenue Code of 1954, and said amounts before the depletion allowances were taken were included in gross income in each of such respective years. In determining plaintiff's taxable income for each of such respective years, upon which federal income taxes were assessed and paid, said percentage depletion which was claimed and allowed at the rate of 27½ percent of the above stated amounts, and other deductions, was deducted from the amounts included in plaintiff's gross income as above stated.

5. In its Federal income tax return for the taxable year 1958, plaintiff deducted the entire $505,536.54 which it was required to restore and repay to both Cities Service and Dorchester in such year. Upon audit by the Govern-

ment certain adjustments were made to plaintiff's income for the taxable year 1958, including the reduction of its otherwise allowable percentage depletion allowance for such taxable year in the amount of $139,022.55, representing 27½ percent of the $505,536.54 which it was required to restore and repay to Cities Service and Dorchester during the taxable year 1958. These adjustments resulted in an additional assessment of tax for the taxable year, which was paid by plaintiff, together with interest thereon. Thereupon, plaintiff filed a timely claim for refund of such tax on the grounds that its otherwise allowable percentage depletion allowance for the taxable year had been erroneously reduced by 27½ percent of the amount which it was required to restore and repay to both Cities Service and Dorchester. This claim was not allowed, and the instant suit for refund was timely commenced.

6. The meaning of Title 26, United States Code, Section 1341, is not clear when applied to the issue herein.

7. At all times pertinent hereto, plaintiff has kept its books and filed its Federal income tax returns on the accrual basis, utilizing a calendar year.

8. Completely apart from the issue herein the defendant has stipulated that plaintiff is entitled to judgment for recovery of tax related to other similar matters in the amount of $17,468.76, plus assessed interest in the amount of $3,463.88, a total of $20,932.64, plus statutory interest thereon, as provided by law, from the respective dates of payment of July 5, 1962, with respect to the tax, and September 4, 1962, with respect to the interest assessed thereon.

CONCLUSIONS OF LAW

1. (a) The Court has jurisdiction of this action under 28 U.S.C. 1346(a)(1).

(b) The plaintiff has paid the tax in full for the taxable period involved herein.

(c) The plaintiff has made a timely claim for refund. Sections 7422(a), 6511(b)(1) of the Internal Revenue Code of 1954.

(d) More than six months have expired since the filing of plaintiff's claim for refund and plaintiff brings this

timely action for its taxable year ended December 31, 1958 pursuant to the provisions of Section 6532(a) of the Internal Revenue Code of 1954.

2. No action or suit has been commenced or is pending in any other Court on account of this claim for refund. Plaintiff is the owner of such claim for refund, and no assignment or transfer of legal title thereto has been made.

3. Plaintiff, at all times pertinent hereto, was a corporation duly organized and existing under the laws of the State of Delaware and maintained its principal office in Tulsa, Oklahoma.

4. An interpretation is required of Title 26, United States Code, Section 1341, which in pertinent parts reads as follows:

"Sec. 1341. Computation Of Tax Where Taxpayer Restores Substantial Amount Held Under Claim Of Right.

(a) General Rule.—if—

(1) an item was included in gross income for a prior taxable year (or years) because it appeared that the taxpayer had an unrestricted right to such item;

(2) a deduction is allowable for the taxable year because it was established after the close of such prior taxable year (or years) that the taxpayer did not have an unrestricted right to such item or to a portion of such item; and

(3) the amount of such deduction exceeds $3,000, then the tax imposed by this chapter for the taxable year shall be the lesser of the following:

(4) the tax for the taxable year computed with such deduction; or

(5) an amount equal to—

(A) the tax for the taxable year computed without such deduction, minus

(B) the decrease in tax under this chapter (or the corresponding provisions of prior revenue laws) for the prior taxable year (or years) which would result solely from the exclusion of such item (or portion thereof) from gross income for such prior taxable year (or years)."

5. The parties have stipulated that the computation of tax liability herein should be under Section 1341(a)(4)

and not (a)(5). This is because the tax rate herein would be 52% in all events.

6. The general purpose of Section 1341 is to allow a taxpayer who has included certain income under a claim of right in his gross income for a prior year to receive adequate and fair tax benefits in the year in which the taxpayer has been required to restore or repay such income. This purpose is set forth by the said enactment of Congress in general terms without specific provisions being made for all types of income. Thus, it becomes necessary to interpret Section 1341 and ascertain the intent of Congress when it is applied as herein to income included in gross income which possesses the right to a depletion allowance to be thereafter taken and the subsequent deduction which is to be allowed in the taxable year when such income must be restored or repaid.

7. General rules of statutory construction apply to the construction of tax status. Where the meaning of a statute is clear, the statute must be enforced as written. United States v. Martin, 337 F.2d 171 (Eighth Cir. 1964).

8. Where court is in doubt as to meaning of statute, it is entitled to look to purpose behind it. Stanley v. C. I. R., 338 F.2d 434 (Ninth Cir. 1964).

9. It is well settled that legislative history, generally speaking, may be resorted to as an aid in determining the proper construction of a statute which is ambiguous or of doubtful meaning. Annot: 70 A.L.R. 5.

10. In the interpretation of statutes, the function of the courts is to construe the language so as to give effect to the intent of Congress. There is no invariable rule for the discovery of that intention. To take a few words from their context and with them thus isolated to attempt to determine their meaning, certainly would not contribute greatly to the discovery of the purpose of the draftsmen of a statute, particularly in a law drawn to meet many needs of a major occupation. United States v. American Trucking Associations, 310 U.S. 534, 84 L.Ed. 1345, 60 S.Ct. 1044 (1940).

11. The most persuasive evidence of the purpose of a statute is the words by which the Congress undertook to give expression to its wishes. If these words are sufficient in and of themselves to determine the purpose of the legis-

lation their plain meaning should be followed. However, when this meaning leads to absurd or futile results the Court must look beyond the words to the purpose of the act. If the plain meaning does not produce an absurd result but merely an unreasonable one plainly at variance with the policy of the legislation as a whole the Court should follow that purpose, rather than the literal words. When aid to construction of the meaning of words as used in the statute, is available, there certainly can be no "rule of law" which forbids its use, however clear the words may appear on "superficial examination." The interpretation of the meaning of statutes, as applied to justiciable controversies, is exclusively a judicial function. Emphasis should be laid upon the necessity for appraisal of the purposes as a whole of Congress in analyzing the meaning of clauses or sections of general acts. A few words of general connotation appearing in the text of statutes should not be given a wide meaning, contrary to a settled policy except when a different purpose is plainly shown. United States v. American Trucking Associations, supra.

12. Section 1341 did not create a new deduction but was enacted to provide relief from the ruling in United States v. Lewis, 340 U.S. 590, 95 L.Ed. 560, which held it mandatory that the taxpayer take a deduction in the year of repayment even though the tax benefit to be derived therefrom might be substantially less than the liability incurred from including the returned income in the year of receipt. National Life & Accident Insurance Company v. United States, 244 F. Supp. 135.

13. It is concluded that it was the intent of Congress that if an item (income) included in gross income by a taxpayer per Section 1341(a)(1) was to thereafter be subject to a depletion allowance for tax purposes that if such taxpayer was in a later tax year to be allowed a deduction thereof per Section 1341(a)(2), the deduction allowable would also be subject to the same treatment and be reduced by the depletion allowance previously effected for tax purposes. O'Meara v. Commissioner, 8 T.C. 622.

14. It is therefore proper that the deduction to be allowed herein for tax year 1958 under Section 1341(a)(2)

would be in the amount of $366,513.99, and not the entire $505,536.54. The taxpayer received the $505,536.54, in money and restored or repaid that identical sum. However, the taxpayer only paid tax on 72½% thereof or on the amount of $366,513.99, and such amount in the intent of Congress and in the spirit of the legislation should be the deduction allowable in 1958 under Section 1341. Any other procedure would do violence to the spirit of the legislation and the intent of the Congress to afford equitable relief to a taxpayer who thought he had a right to keep certain of his income and paid taxes thereon but it later turns out that he had no such right and was required to restore or repay the same. Congress intended that a taxpayer should get at least equal tax benefit but cannot have intended that a taxpayer should get a deduction allowable for income on which he had not previously paid a tax because of some benefit accruing to the specific income such as a depletion allowance. National and O'Meara, supra.

15. By this procedure the taxpayer herein will get tax benefits in 1958 equal to taxes paid during the preceding years regarding this restored income. This is deemed to be the prime intent of Congress as expressed in the enactment involved herein. H. Rep. No. 1337, 83d Cong., 2d Sess., p. 86 (3 U.S.C. Cong. & Adm. News (1954) 4017, 4113); S. Rep. No. 1622, 83d Cong., 2d Sess., 118 (3 U.S.C. Cong. & Adm. News (1954) 4621, 4751).

16. As the defendant is in no way reopening or readjusting plaintiff's returns for the years 1952-1957, there is no violation of the annual accounting concept. Arrowsmith v. Commissioner, 344 U.S. 6, 97 L.Ed. 6, 73 S.Ct. 71 (1952); Douglas v. Commissioner, 322 U.S. 275, 88 L.Ed. 1271, 64 S.Ct. 988 (1944).

DECISION.

It is the decision, therefore, of the Court for the foregoing reasons that the plaintiff should receive nothing herein except that per stipulation herein the plaintiff should recover judgment herein in the sum of $20,932.64 plus statutory interest thereon against the defendant herein.

The defendant will prepare an appropriate judgment based on the foregoing for signature of the Court. Rule 58, F.R.Civ.P. 28 U.S.C.A.

Dated this 2 day of June, 1966.

FRED DAUGHERTY
United States District Judge.

Filed June 2, 1966.

JUDGMENT

This cause came before this Court for consideration and decision on a Joint Stipulation of Facts and Briefs filed by the parties herein, and, upon consideration of the same, this Court entered its Findings of Fact, Conclusions of Law and Decision herein on June 2, 1966. In accordance with the Findings of Fact, Conclusions of Law and Decision of this Court, it is hereby

Ordered, Adjudged and Decreed that, in accordance with the parties' Joint Stipulation of Facts, the plaintiff have and recover of and from the defendant the amount of $20,932.64, together with interest thereon according to law; it is further

Ordered, Adjudged and Decreed that the complaint and action herein be dismissed with prejudice insofar as any recovery greater than that above-cited is claimed.

Entered this 21 day of June, 1966, at Tulsa, Oklahoma.

FRED DAUGHERTY,
United States District Judge.

Filed June 21, 1966.

Approved: Robert J. Casey, Counsel for Plaintiff; John O. Jones, Tax Division, Department of Justice, Counsel for Defendant.

NOTICE OF APPEAL

Notice is hereby given that Skelly Oil Company, Plaintiff above named [and Appellant herein], appeals to the Court of Appeals for the Tenth Circuit from so much of the Judgment entered in this action on the 21 day of June, 1966, as denied Plaintiff's claim for recovery from Defendant of any amount greater than $20,932.64 together with interest thereon according to law.

Dated: 22 day of June, 1966.

ROBERT J. CASEY

Of Counsel:

Clark, Carr & Ellis

DONALD P. MOYERS

Of Counsel:

Martin, Logan, Moyers,
Martin Conway.

Filed June 22, 1966.

No. 8822 DOCKET ENTRIES IN COURT OF APPEALS

Date	
7-15-66	Statement of points relied on by taxpayer.
4-20-67	Opinion, Seth, J.
4-20-67	Judgment.
6-26-67	Order granting rehearing.
4- 3-68	Opinion on rehearing, Seth, J.
4- 3-68	Dissenting opinion on rehearing, Hill, J.
4- 3-68	Judgment.

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 8822

SKELLY OIL COMPANY, APPELLANT

vs.

UNITED STATES OF AMERICA, APPELLEE

APPELLANT'S STATEMENT OF POINTS RELIED ON

The points upon which appellant intends to rely on this appeal are as follows:

1. The District Court erred in applying Title 26, United States Code, Section 1341(a)(4) in that it concluded that Plaintiff-Appellant is not entitled to the full amount of the otherwise allowable deduction of $505,536.54 for the taxable year 1958, because the stipulated facts clearly indicate that Plaintiff-Appellant meets each of the requirements necessary to a deduction in such amount, said requirements being set forth in Title 26, United States Code, Sections 1341(a)(1), (a)(2) and (a)(3).

2. The District Court's Finding of Fact set forth in paragraph 6 of its Finding of Fact is erroneous, because said Finding is not supported by the Record, and further because Title 26, United States Code, Section 1341 is clear and unambiguous when applied to the issue in this proceeding.

3. The District Court erred as a matter of law in resorting to the legislative history which accompanied the enactment of Title 26, United States Code, Section 1341, because as enacted, said Section 1341 is clear and unambiguous.

4. Assuming resort to the aforesaid legislative history is permissible, the District Court erred in concluding that Congress, in enacting Title 26, United States Code, Sec-

tion 1341(a)(4), intended to limit an otherwise allowable deduction in the current year to an amount measured by the amount previously included in taxable income with respect to the restored item in the year or years of its original receipt because:

a. the legislative history does not express any such intention;

b. such a conclusion results in the application to Plaintiff-Appellant of the "transactional approach" to restored claim of right income which has been expressly rejected by the Courts and the Congress;

c. such a conclusion violates the annual accounting concept which was expressly adopted by Congress in its enactment of Title 26, United States Code, Section 1341; and

d. such conclusion is inconsistent with Title 26, United States Code, Section 1341 itself, which provides that the tax shall be the lesser of the tax computed pursuant to subsection (a)(4) and the tax computed pursuant to subsection (a)(5) thereof.

5. The District Court erred in relying on the Tax Court's decision in Maurice P. O'Meara, 8 T.C. 622 (1947) because said case:

a. was decided prior to the enactment of Title 26, United States Code, Section 1341(a)(4);

b. is not controlling under Title 26, United States Code, Section 1341(a)(4);

c. is factually distinguishable from this proceeding; and

d. reflects inconsistent holdings by the Tax Court.

6. The District Court erred by failing to conclude that Defendant-Appellee's adjustment of Plaintiff-Appellant's percentage depletion deduction by the amount of $139,022.55 for the year 1958 was erroneous without regard to the merits of the issue of whether Title 26, United States Code, Section 1341(a)(4) would reduce an otherwise allowable deduction.

7. The District Court erred in failing to conclude that Defendant-Appellee has abandoned any contention that said percentage depletion allowance should be so reduced, because Defendant-Appellee failed to present to said District Court any argument directed to that proposition.

8. In concluding that Congress intended to restrict an otherwise allowable deduction to reflect the tax detriment suffered on account of the inclusion of the restored item in taxable income for the prior year or years, the District Court erred in presuming that Congress would legislate a nullity in subsection (a)(4) of Title 26, United States Code, Section 1341.

Dated: July 14, 1966.

ROBERT J. CASEY

Of Counsel:
Clark, Carr & Ellis

DONALD P. MOYERS

Of Counsel:
Martin, Logan, Moyers, Martin & Conway.

Filed July 15, 1966.

OPINION

Filed, United States Court of Appeals, Tenth Circuit, Apr 20, 1967, William L. Whittaker, Clerk

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UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

No. 8822—APRIL 1967 TERM

SKELLY OIL COMPANY, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

Appeal From The United States District Court For The Northern District of Oklahoma.

Robert J. Casey, New York City (Donald P. Moyers, Tulsa, Okla.; Of Counsel, Clark, Carr & Ellis, New York City, and Martin, Logan, Moyers, Martin & Conway, Tulsa, Okla., with him on the Brief), for Appellant.

Myron C. Baum, Attorney, Department of Justice, Washington, D.C. (Mitchell Rogovin, Assistant Attorney General, Lee A. Jackson, Melva M. Graney, Loring W. Post, Attorneys, Department of Justice, Washington, D. C.; Of Counsel, John M. Imel, United States Attorney, and Lawrence A. McSoud, Assistant United States Attorney, Tulsa, Okla., with him on the Brief), for Appellee.

Before MURRAH, Chief Judge, HILL and SETH, Circuit Judges.

SETH, Circuit Judge.

The appellant brought this action for refund of income taxes on the ground that it was entitled in full to a deduction under Section 1341(a) (4) of the Internal Revenue Code of 1954, for refunds to corporations which purchased gas from it made following a price reduction.

The trial court reduced the claimed deduction by the amount of the percentage depletion deduction, and the taxpayer has taken this appeal.

The appellant has been in the business of producing and selling natural gas in Oklahoma for many years, and was so engaged during the period when a state minimum price order for natural gas sales at the wellhead was put into effect. This order raised the price of the gas appellant was selling under preexisting contracts, and continued in effect until it was declared invalid in Michigan Wisconsin Pipe Line Co. v. Corporation Commission of Oklahoma, 355 U.S. 425. After the order was terminated, a purchaser of gas from appellant during the period the order was in effect brought a suit to recover from Skelly the difference between the contract rate and the price order rate. This suit was settled by the repayment by appellant to the purchaser of the sum of $500,000.00. Appellant paid another purchaser in a similar position the sum of $5,536.54.

The total of these two amounts was claimed and entered in its return as a deduction in 1958, the year it was paid. This was done pursuant to Section 1341(a) (4) of the Code of 1954 in that it was established after the close of the prior taxable years that the taxpayer did not have an "unrestricted right" to such "an item" which was included in its gross income because it appeared it had such right for several prior taxable years, 1952 through 1957.

As indictated above, appellant claimed it was entitled to deduct the entire amount of the refunds. The trial

court did not allow this amount, but instead reduced it by 27-½ per cent which was the percentage appellant had deducted in its returns for the years 1952-57 from its gas sales as depletion.

The statute (Section 1341 of the Internal Revenue Code of 1954) provides in part that:

> "(a) General rule—If—
>
> "(1) an item was included in gross income for a prior taxable year (or years) because it appeared that the taxpayer had an unrestricted right to such item;
>
> "(2) a deduction is allowable for the taxable year because it was established after the close of such prior taxable year (or years) that the taxpayer did not have an unrestricted right to such item or to a portion of such item; and
>
> "(3) the amount of such deduction exceeds $3,000,
>
> "then the tax imposed by this chapter for the taxable year shall be the lesser of the following:
>
> "(4) the tax for the taxable year computed with such deduction; or
>
> "(5) an amount equal to—
>
> "(A) the tax for the taxable year computed without such deduction, minus
>
> "(B) the decrease in tax . . . for the prior taxable year . . . which would result solely from the exclusion of such item . . . from gross income for such prior taxable year . . . ."

The parties stipulated in the trial court that appellant's taxes for the year 1958 are to be computed under the above subsection (a) (4).

As to the ground rules, it is apparent that the burden was on the appellant under these circumstances to establish a deduction. Corn Products Refining Co. v. Comm'r,

350 U.S. 46. Further as a general proposition a narrow construction is placed on statutory provisions for deductions. United States v. Olympic Radio & Television, Inc., 349 U.S. 232. The rules as to construction generally are contained in United States v. Allen, 293 F.2d 916 (10th Cir.), and in United States v. American Trucking Ass'ns, Inc., 310 U.S. 534.

The taxpayer argues on this appeal that the express wording of the section should be applied, and there are involved at least two separate and distinct tax events each fitting nicely into the statutory language. It also urges that the deduction dollars were without question paid out, and cannot be or should not be traced to their origin in a prior year.

On the other hand the Government argues that Congress could not have intended that such a benefit accrue to the taxpayer, that the several events are related, and one should be used to define the other.

The trial court concluded that the section was not clear, and resort should be had to its legislative history. Also it concluded that the policy of the legislation would not permit the result sought by the taxpayer, it being an unreasonable one. The court concluded that: "Congress intended that a taxpayer should get at least equal tax benefit but cannot have intended that a taxpayer should get a deduction allowable for income on which he had not previously paid a tax because of some benefit accruing to the specific income such as a depletion allowance. National and O'Meara, supra."

When the facts in the case at bar are set against the bare wording of the statute it appears that the requirements are satisfied to permit a deduction in the full amount. The "item" here considered was included in the "gross income" of the taxpayer during the several years prior to 1958, and it appeared that it had the unrestricted right thereto. Further "a deduction is allowable for the taxable year [1958]" because the facts show that after 1957 the taxpayer did not have the unrestricted right to "a portion of such item," and the amount of the deduction is greater than $3,000.00. Thus the tax for 1958 would be computed with "such deduction." It is apparent that

the term "gross income," "exclusion," and "deduction" used in the statute have well defined meanings. The parties stipulated that the $505,536.54 had all been included in the taxpayer's "gross income" for the years 1952-57. Thus if the wording is applied without more, the appellant is entitled to the entire deduction.

Before Section 1341 was enacted, a taxpayer in appellant's position was permitted to deduct the amount of the item restored in the year it was so returned. The "claim of right" doctrine was firmly established by North American Oil Consol. v. Burnet, 286 U.S. 417. There was no alternative, however, if any remedy was sought as was held in both United States v. Lewis, 340 U.S. 590, and in Healy v. Comm'r, 345 U.S. 278. There thus existed the possibility that the taxpayer would be benefitted by the deduction over the treatment he would otherwise have received, or that he would be prejudiced. The result was then determined by a number of factors in the tax computation for the two or more years including the most obvious one—a change in tax rates. Thus the taxpayer in the pre-Section 1341 period was at the mercy of the circumstances with no choice given to him. The above cited cases establishing and refining the "claim of right" rule also reiterated the annual accounting doctrine and asserted it must be applied despite inequities which might arise from it.

For the present consideration it is sufficient to note that before Section 1341 a taxpayer by virtue of the permitted deduction could receive more benefit than the tax originally paid by him upon the "item" which had to be restored. Thus a benefit in the current year was recognized as a possibility, but not limited or related to the tax paid on the item in the previous year. It was then treated as any other deduction for these purposes in the year of restoration.

The change in "law" by the statutory enactment of Section 1341, considering the wording alone, was by the addition of the provision in subsection (a) (5) directed to those taxpayers who would suffer a disadvantage by the use of a current year deduction. This prejudice was removed by permitting the recomputation of taxes for the

current year without the deduction and then a reduction of the tax so computed by the amount of tax attributable to the use of the restored amount in the earlier year if such a route would result in a lesser tax than would a current year deduction. The alternative recomputation provision appears in subsection (a) (5), and the current year deduction is recognized in (a) (4), as it existed before in a non-statutory form. It must be assumed that Congress had a real purpose in enacting the new remedy in (a) (5), and that it was to afford some needed relief in giving the taxpayer an alternative. There is nothing in the enactment itself to indicate an attempt to change the current year deduction remedy.

Thus it appears that Congress by Section 1341 enacted the existing rule as to current year deductions, and added another and new provision whereby the taxpayer who qualifies can always receive a tax benefit from the deduction at least equal to the tax on the item when added to income, "and may receive a tax benefit of a greater amount." 2 Mertens, Law of Federal Income Taxation 340, ch. 12, § 12.106a (Zimet & Stanley Rev.). Thus it must be concluded that Congress sought to make no change in the current year deduction remedy, but only added the recomputation provision. The statutory enactment may have been precipitated by the strict application of the annual accounting rule in cases such as Healy v. Comm'r, 345 U.S. 278, 14 Oil & Gas Tax Quarterly 70.

The trial court found that the section was unclear or ambiguous, and resorted to the legislative history of the enactment of Section 1341. We do not decide whether or not the resort to the history was proper, or whether the wording is without such ambiguity. The legislative history leads to the same conclusion as does the examination of the preexisting state of the law and the statutory language described above.

The cases permit the examination of transactions taking place in prior years to identify or to characterize transactions in the current year. Arrowsmith v. Comm'r, 344 U.S. 6 (a pre-Section 1341 case), is an example. This may be done without violating the annual accounting principle, and a form of it appears in subsection (a) (5);

however, we see no reason in the Act to reexamine the prior years' transactions in the case before us. The statute in subsection (a) (4), with which we are here concerned, does not require or indicate in any way that this be done.

The Government places great reliance on O'Meara v. Comm'r, 8 T.C. 622, 1947. There the taxpayer reported as income certain royalties received from oil production. He was later found by a court not to have title to the lease or land and had to repay the amounts received. This factor is an obvious distinction from the case at bar. There the question became whether the taxpayer was entitled to any deduction at all in the current year. See also Parr v. Scofield, 185 F.2d 535 (5th Cir.). The Tax Court in O'Meara held the taxpayer was entitled to a deduction in the current year of the amount repaid less the depletion allowance. The point with which we are here concerned is not developed in the opinion as the court does not indicate how the deduction for depletion should be applied. In any event the subsequent enactment of Section 1341 without stating any conditions or adjustments makes the cited case of doubtful authority.

To apply the rule sought by the Government would require the imposition of a limitation on the use of Section 1341(a) (4) determined by the amount of taxes paid by appellant in the prior years. There was no limitation or adjustment required in the doctrine expressed in (a) (4) before its enactment, and none is indicated in the statute. There appears to be no relationship established by Congress between (a) (4) and the prior year's computation other than those expressed in the Act, none of which are here pertinent. The Section only requires the tax for the current year to be figured "with such deduction."

There is no authority to permit a readjustment of the depletion allowance of the prior years nor may later happenings alter it. Hugoton Production Co. v. United States, 349 F.2d 418 (Ct.Cl.).

Further there is no indication that the source of the dollars used in the repayment was to be considered before Section 1341 (a) (4) nor thereafter, any more than the source of the dollars used for other deductions.

Much could be written on the subject of general policy about the result of this application of the statute without a judicial addition of conditions. This is however a specific, narrow statutory provision for a particular set of circumstances, and no broad general policy of Congress is indicated. The words used in the section have a clearly recognized meaning in the tax field, and the whole section is consistent when applied as its words direct. The refund problem and depletion was well recognized at the time of the statutory enactment.

The benefit which may accrue to the appellant is large, and thus it is different from previous instances where the benefit was small although well recognized; however, we see no reason to make a distinction based on the amount of money involved to override the statutory provisions. The trial court made no such distinction, but instead indicated that the general principles and the O'Meara case led to an addition of requirements not expressed in the statute. We cannot agree with this either, as the mandate of Congress is clear.

REVERSED.

JUDGMENT

TWENTY-FIFTH DAY, MARCH TERM, THURSDAY, APRIL 20th, 1967.

Before Honorable Alfred P. Murrah, Chief Judge, and Honorable Delmas C. Hill and Honorable Oliver Seth, Circuit Judges.

SKELLY OIL COMPANY, APPELLANT

vs.

UNITED STATES OF AMERICA, APPELLEE

Appeal from the United States District Court for the Northern District of Oklahoma.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Oklahoma and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said district court in this cause be and the same is hereby reversed, and that this cause be and the same is hereby remanded to the said district court for further proceedings in accordance with the views expressed in the opinion of the court.

ORDER GRANTING REHEARING

Before Honorable Alfred P. Murrah, Chief Judge, and Honorable Delmas C. Hill and Honorable Oliver Seth, Circuit Judges.

SKELLY OIL COMPANY, APPELLANT

vs.

UNITED STATES OF AMERICA, APPELLEE

Appeal from the United States District Court for the Northern District of Oklahoma.

It is ordered that the petition for rehearing is granted and that this cause be set for re-argument July 13, 1967.

It is further ordered that the judgment of this court entered April 20, 1967, is vacated.

OPINION

Filed, United States Court of Appeals, Tenth Circuit, April 3, 1968, William L. Whittaker, Clerk

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UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

No. 8822—MARCH 1968 TERM

SKELLY OIL COMPANY, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

ON PETITION FOR REHEARING

Robert J. Casey, New York City (Thomas E. Tyre, John A. Craig, and Clark, Carr & Ellis, New York City, of Counsel, with him on Brief in Regard to Appellee's Petition for Rehearing), for Appellant.

Myron C. Baum, Attorney, Department of Justice, Washington, D.C. (Mitchell Rogovin, Assistant Attorney General, Lee A. Jackson, Loring W. Post, Attorneys, Department of Justice, Washington, D.C., with him on Petition for Rehearing), for Appellee.

Before MURRAH, Chief Judge, HILL and SETH, Circuit Judges.

SETH, Circuit Judge.

The appellee filed a petition for rehearing which was granted. Additional briefs were submitted and oral argument was heard.

The parties, for better or worse, agreed during the litigation that 26 U.S.C. § 1341(a)(4) was the applicable provision. The case was tried on this basis and so presented to this court.

On rehearing, as well as on the original presentation, the Government urges that the case of O'Meara v. Comm'r, 8 T.C. 622 (1947), is determinative of the issue. The Government also urges that a construction of the section contrary to their position is not in accordance with the "spirit" of the legislation.

We are not prepared to rest this decision on the "spirit" of this portion of the statute. The rules of statutory construction are well established, and we are faced with a clearly worded section which refers to a very narrow point. This is not a provision referring to a matter of broad scope. Under these circumstances we must take it at face value.

The continued reliance by the Government on O'Meara v. Comm'r, 8 T.C. 622 (1947), is of little assistance, but it is understandable. It is obviously part of the pre-statute (1954) case law on this point, but if it did develop any new condition, such a condition was not carried over into the present section of the law. The matter of refunds of this character was well known when the statute was enacted, and we must assume that if Congress intended to create a condition as to the applicability of the section, it would have done so.

The O'Meara case does not purport to define "deductions" or anything else. This term, and the others here concerned, were defined by a myriad of cases where the issue was involved, both before and after O'Meara. Thus O'Meara was obviously part of the case law, but nothing it decided was incorporated in the statute nor influenced the construction of established tax terminology.

As stated in the original opinion, under these circumstances we cannot add a condition to the statute expressly or by a redefinition of terms, although we might wish to do so in view of the results. It is apparent that some remedial steps should be taken, but we cannot do so.

We adhere to our original opinion and disposition of the case. REVERSED.

HILL, Circuit Judge, Dissenting.

This is a close and difficult case and one that has caused each member of the panel to burn some midnight oil. After the case was first submitted to us I agreed with my brothers that by a strict interpretation of 26 U.S.C. § 1341(a)(4) appellant was entitled to prevail and the opinion of the court was so written. Thereafter, and by a unanimous vote, a petition for rehearing was granted and the case was reargued, I then became convinced that our original decision was not correct and that the trial court should be affirmed. Therefore, I must now respectfully dissent.

I believe the trial judge was correct in reasoning that § 1341(a)(4) did not create a new deduction and that thus the O'Meara decision [1] applied in the determination of the deduction allowable. The majority fails to present any reason for divorcing the determination of the deduction from its initiating basis.

The cornerstone of appellant's argument and the position apparently accepted by the majority is that "the statute utilizes interchangeably the phrase 'item included in gross income in prior year' with the term 'deduction.'" It is my contention that these two phrases are not used interchangeably and that a more reasonable interpretation of the statute is that the "deduction" to be allowed may in appropriate situations differ significantly from the item included in gross income. At no time does the majority define "deduction" as it is used in § 1341. It is, however, asserted that "deduction" has a well defined meaning. This can only refer to the meaning developed in pre-1341 cases dealing with the problem of refund of prior "claim of right" income. Indeed the majority recognizes that "the current year deduction is recognized in (a)(4) as it existed before in a non-statutory form." However, the majority's further statement that prior to the enactment of § 1341 "a taxpayer in appellant's position was permitted to deduct the amount of the item restored in the year it was so returned" without any reference to the O'Meara decision is misleading to say the least and is undoubtedly the crucial error in the majority's reasoning. O'Meara is

[1] Maurice P. O'Meara, 8 T.C. 622 (1947).

bypassed by my distinguished brothers with the statement that "The point with which we are here concerned is not developed in the opinion as the court does not indicate how the deduction for depletion should be applied. In any event the subsequent enactment of Section 1341 without stating any conditions or adjustments makes the cited case of doubtful authority."

To me it is much more reasonable to say that the existence of O'Meara in the case law pre-dating the enactment of § 1341 means that it must be considered as a part of the definition of "deduction" that arises from the case law. Certainly an examination of O'Meara shows that the court considered the problem of the effect of taking a prior depletion deduction on claim of right income which was later returned. The O'Meara case concerned a suit for refund of taxes which had been previously paid by O'Meara on royalties received from certain oil properties which had been acquired by O'Meara by warranty deed. During the years when such income was included O'Meara had taken the allowable depletion allowance on such royalties. Subsequently as a result of litigation O'Meara was held to have had unlawful possession of the mineral properties and was required to pay over all royalties received from such property. On his later return O'Meara deducted the amount so repaid and this deduction was disallowed by the Commissioner. The Tax Court reversed the Commissioner's rule and allowed the deduction,[2] limiting it and reducing it by the amount that O'Meara had previously taken as a depletion allowance.

Concerning the problem of reduction of the allowable deduction the court in O'Meara stated:

> "[T]he amount of loss for which petitioner is entitled to the deduction must be limited by the amount of the royalty income reported for tax purposes after

[2] It is interesting to note that in 1341(a)(1) the term "an item included in gross income" is used as a requirement for the application of the statute. This same requirement was established in O'Meara, supra, to be the sole requirement for the establishment of a basis for later gains or losses. As discussed later there is, however, a significant difference between establishing a basis and allowing the full amount as a deduction.

deducting for depletion. It makes little difference whether the depletion deduction be viewed as a diminution of income, thereby resulting in effect in a reporting by petitioner of only the net amount of 72½% of the royalties received rather than 100%, or whether we recognize that the depletion deduction is permitted to one in the position of the owner of the oil in place or of a depletable interest therein, and that when it developed that petitioner was not the owner the deduction became erroneous, and petitioner is required to include the deducted amount as income in the year when that situation appears; see Douglas v. Commissioner, 322 U.S. 275; or whether the adjustment is viewed as required by the statutory definition of basis. Section 113(b)(1)(B), I.R.C. See Virginia Hotel Corp. v. Helvering, 319 U.S. 523. In any event, the net amount of the loss for which petitioner is entitled to take a deduction is the total of the royalties reported less the amount deducted for depletion." O'Meara, supra, at 634-5.

Appellant asserts that only the second of the above mentioned grounds for the reduction is valid; since in the instant case there was no question but that Skelly was at all times the legal owner of the land the O'Meara case is distinguishable and not applicable to the instant case. Apparently the court in O'Meara, however, felt that any of the above three mentioned grounds would be sufficient to uphold the government's argument that the deduction should be reduced by the amount of the depletion deduction previously taken.

I suggest that O'Meara stands for the basic principle that a basis established for gain or loss by the inclusion of income under a claim of right, which income has been the basis for a percentage depletion deduction, must be limited by that amount of the directly related deduction,[3] and

[3] A short analysis of the depletion deduction shows its direct relation to the gross income produced from a well and illustrates further why in recognizing a deduction for return of such income cognizance must be given the percentage depletion deduction.

A depletion deduction is allowed a taxpayer whose income results from production from a natural resource. In receiving such income

that the reasoning and applicability of the O'Meara decision is just as applicable today as it was before the enactment of § 1341. I agree entirely with Judge Daugherty when he states "Any other procedure would do violence to the spirit of the legislation and the intent of the Congress to afford equitable relief to a taxpayer who thought he had a right to keep certain of his income and paid taxes thereon but it later turns out that he had no such right and was required to restore or repay the same. Congress intended that a taxpayer should get at least equal tax benefit but cannot have intended that a taxpayer should get a deduction allowable for income on which he had not previously paid a tax because of some benefit accruing to the specific income such as a depletion allowance." In fact any other position would appear to be totally unreasonable. The resulting effect would be that two measures intended to relieve and benefit the taxpayers can combine to result in a windfall to the taxpayer greatly exceeding the benefit which might result from the separate application of these measures. That such an overall result was intended seems unlikely.

It was argued by appellant that the statement of the court in O'Meara that "the process of establishing a basis

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the natural resource is depleted, thus depleting the taxpayer's capital investment. In computing other forms of income, i.e., such as a manufacturer's income, the capital investment of the manufacturer is considered and deducted. Thus in a similar sense a depletion deduction from income received from a natural resource is allowed as a return of the taxpayer's capital. 4 Mertens, § 24.02. Such depletion allowance was originally considered on two grounds, a cost depletion and a discovery depletion. Both of these depletion allowances had a specific limit upon the total amount of depletion that could be taken; however, these depletion limitations proved somewhat unsatisfactory as they made computation of the depletion difficult. Therefore, a percentage depletion deduction was established whereby the depletion deduction was made a direct function of the amount of income received from the natural resource. 4 Mertens, § 24.04. There is no limitation on the amount of depletion deductions which may be taken over a period of years such as with the cost of depletion or like the depreciation allowance allowed for the equipment used by a manufacturer. It is clear in fact that the total depletion deduction taken from a natural resource could far exceed the total cost of the natural resource. Commissioner v. Southwest Exploration Co., 350 U.S. 308.

for an income item consists * * * of reporting it in the taxpayer's gross income * * *" Id. at 633, required that no further consideration be given to any depletion deduction taken from said income in the computation of the deduction allowable in the year of the repayment. The Tax Court in making this statement, however, was not considering the problem of the amount of deduction allowable but merely that the government did not have to receive any tax benefit from the inclusion of the income in the return in the prior year. The mere reporting of the item as gross income established a basis. The court, however, did not go on to say that the entire item included in gross income would establish the amount of the basis. This was not considered until the later portion of the opinion quoted above, where the court found that the deduction allowable was not equatable with the total amount included in gross income but was limited by the depletion deduction previously taken. No inconsistency results from saying that the inclusion of an item in gross income establishes a basis for later deductions notwithstanding lack of tax benefit to the government but not allowing a taxpayer to include the entire amount included in gross income as a basis for deduction.

Consideration of the percentage depletion deduction in determining the deduction allowable under § 1341 does not violate the annual accounting concept as established by Burnett v. Sanford & Brooks Co., 282 U.S. 359, as the consideration of the prior years' returns is only for the purpose of determining the amount of the allowable deduction in the present year's return. There is no reopening or refiguring of prior years' taxes, merely a computation of the present year's taxes. That consideration of the prior years' returns may be made is clearly established by cases such as Arrowsmith v. Commissioner, 344 U.S. 6; Douglas v. Commissioner, 322 U.S. 275; and Dobson v. Commissioner, 320 U.S. 489. Cases cited by appellant such as Healy v. Commissioner, 345 U.S. 278, concern the taxpayer's proposition that the tax for the prior years be recomputed and that refunds be made from the taxes paid in the prior years. This situation is clearly not the one before us in the instant case. Here, as mentioned above, we are merely determining the

amount of the allowable "deduction" in the present taxpaying year. The majority cites the case of Hugoton Production Co. v. United States, 349 F.2d 418, as authority for the proposition that consideration may not be given of the prior taxpayer years. The Hugoton case, however, is not direct authority for this proposition. That case involved the determination of the price received by similarly situated producers for purposes of establishing wellhead prices for depletion allowances. In the computation of such prices, the court stated that it could not consider refunds made by such other producers under situations similar to that of the instant case and gave as its reasons for not considering such refunds the annual accounting concept. The court went on to note, however, that such refunds would be reflected in any respect as they were considered in the subsequent years when the repayments were made. It should suffice for the Hugoton case to say that the question considered by the court there was not the question which we are considering in the instant case. One could go on to question, however, whether the application of the annual accounting concept to the situation found in the Hugoton case required the result reached by that court. In any respect it is reasonable to say that consideration of prior depletion deductions allowed in computing a "deduction" allowable under §1341(a)(4) for a current tax year is not a violation of the annual accounting concept.

In summary, the deduction for refunded claim of right income as originally established by case-law and continued by § 1341 was to provide relief for a taxpayer from the application of the strict claim of right doctrine. It is unreasonable to transfer such relief into a windfall for the taxpayer unless such a result is clearly and unavoidably required. A double deduction should not be given unless there is virtually no alternative. Here I believe the more reasonable decision to be to limit appellant's allowable deduction by the amount of percentage depletion deduction previously claimed.

JUDGMENT

MARCH TERM, WEDNESDAY, APRIL 3rd, 1968.

Before Honorable Alfred P. Murrah, Chief Judge, and Honorable Delmas C. Hill and Honorable Oliver Seth, Circuit Judges

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SKELLY OIL COMPANY, APPELLANT

vs.

UNITED STATES OF AMERICA, APPELLEE

Appeal from the United States District Court for the Northern District of Oklahoma.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Oklahoma and was argued by counsel on January 10, 1967. On April 20, 1967, an opinion was filed reversing the judgment of the district court and remanding the cause to the said district court for further proceedings in accordance with the views expressed in the opinion of the court, and on that same date judgment in accordance with the opinion was entered. Thereafter on June 26, 1967, appellee's petition for rehearing was granted, the judgment of April 20, 1967, was vacated, and the cause was reargued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment entered on April 20, 1967, be and the same is hereby reinstated and the judgment of the said district court is reversed and the cause remanded to the district court for further proceedings in accordance with the views expressed in the opinion of the court.

Honorable Delmas C. Hill, Circuit Judge, dissented.

SUPREME COURT OF THE UNITED STATES

No. 280, October Term, 1968

UNITED STATES, PETITIONER

v.

SKELLY OIL COMPANY

ORDER ALLOWING CERTIORARI—Filed October 14, 1968.

The petition herein for a writ of certiorari to the United States Court of Appeals for the Tenth Circuit is granted, and the case is placed on the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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